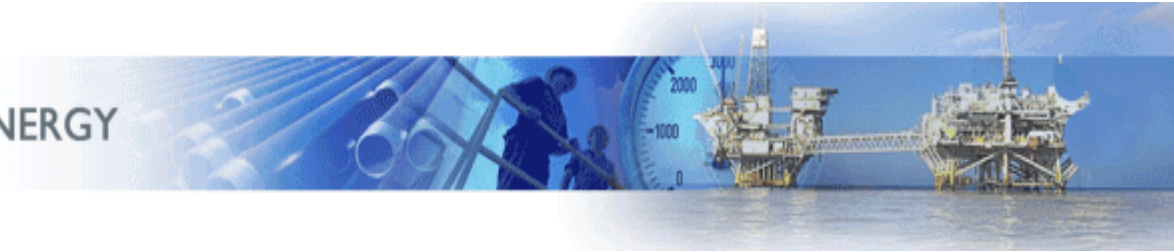




PACIFIC ENERGY



**PACIFIC ENERGY RESOURCES LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2008**

PACIFIC ENERGY RESOURCES LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE PERIOD ENDED SEPTEMBER 30, 2008

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of our operating results and financial position should be read in conjunction with our unaudited financial statements for the period ended September 30, 2008, and related notes (collectively, "financial statements"), which have been prepared in accordance with accounting principles generally accepted in Canada ("GAAP"). This discussion and analysis is current for the Company through November 13, 2008.

Forward-Looking Statements

Certain information in this discussion and analysis contains forward-looking statements and assumptions, such as those related to results of operations and financial condition, capital spending, financing sources, commodity prices, costs of production, results of acquisition projects, environmental risks, regulatory matters, and the magnitude of oil and gas reserves. The reader is also directed to statements regarding future wells to be drilled in our Beta and Alaska operations including our joint drilling program with Chevron, the Corsair exploration prospect, negotiations with our lenders, and statements related to our ability become profitable at some time in the future. These should all be treated as forward looking statements derived by management's opinion and the use of outside consultants. By their nature, forward-looking statements are subject to numerous risks and uncertainties that could significantly affect anticipated results in the future and accordingly actual results may differ materially from those predicted as a result of a variety of factors, including without limitation, those described in the "Risk Factors" section of our most recent Annual Information Form and the following:

- prices of oil and natural gas have been and are expected to continue to be subject to significant fluctuations;
- operating results following our acquisitions may not be as expected;
- competitive pressure among companies in the industry in which we operate may increase significantly;
- costs or difficulties related to the integration of businesses we acquire may be greater than expected;
- changes in the interest rate environment may adversely affect our asset values or increase our borrowing costs;
- general economic conditions, whether nationally or in the market areas in which we conduct business, may be less favorable than expected;
- legislation or regulatory changes may adversely affect the business in which we are engaged;
- the effects of technological changes or obsolescence relating to our products and services;
- the effects of government regulation or shifts in government policy;
- the uncertainty of the productivity of drilled oil and natural gas wells may adversely affect our ability to produce oil and/or natural gas in commercial quantities;
- if we cannot meet our substantial capital requirements, our growth and operations may be hindered;

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- weather disturbances or natural occurrences such as earthquakes could disproportionately affect our production or transportation due to our geographic concentration;
- significant changes in the cost or availability of gathering systems, pipelines and processing facilities may affect our ability to produce and market oil and natural gas;
- adverse changes may occur in the securities markets generally;
- conditions in the equity and debt markets or our financial condition may render us unable to achieve desired reductions in our debt burden or overall cost of debt; and
- the uncertainty surrounding our ability to successfully negotiate revised credit agreements could have a significant impact on future earnings and cash flow.

We also can not guarantee that we will be able to meet all of the requirements to continue to own the Corsair leases.

Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and as such, undue reliance should not be placed on forward-looking statements. We disclaim any intention or obligation to update or revise these forward-looking statements, whether as a result of new information, future events, or otherwise, subject to our obligations under applicable securities laws.

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Overview

We are an independent oil and gas production and development company with operations offshore California and Alaska. We are focused on the acquisition, exploitation, and development of oil and gas properties. Our strategy is to develop our large inventory of proved undeveloped reserves. We plan to supplement this low risk exploitation strategy from time to time by participating in higher risk exploration projects.

Summary

We are pleased to report the accomplishments of the third quarter of 2008:

- Production from continuing operations (after giving effect for divestitures that closed in July 2008) was 7,412 barrels of oil equivalent per day ("boe/d"), up 9.3% from 6,780 boe/d in the second quarter of 2008. The change is due to the increased production from Platform Eureka in the Beta Field.
- Lease operating expenses ("LOE") decreased by 7.0% to \$36 per barrel when compared to the second quarter of 2008.
- We closed both parts of our two onshore California divestitures for net proceeds of approximately \$128 million. Approximately \$63 million was used to pay down debt, \$30 million was used to extinguish hedge contracts, \$6 million was used to terminate the non-controlling interest in the properties sold, with the balance used to replenish working capital.
- On October 23, 2008, we reached our phase II production targets for Platform Eureka with production exceeding 2,000 boe/d.
- We hired Gerry Tywoniuk as our new Chief Financial Officer effective August 15, 2008, adding his experience in oil and gas, capital markets and accounting to our organization.

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Beta Field (offshore Long Beach, California)

Including both Platforms Eureka and Ellen, total Beta Field production was 2,905 boe/d in the third quarter of 2008, compared to 2,475 boe/d in the second quarter of 2008, 1,814 boe/d in the first quarter of 2008 and 1,523 boe/d in the third quarter of 2007. This significant production growth is due to a program to return Platform Eureka to production, with first production beginning in April 2008.

Platform Eureka had been shut in since 1999 and was returned to production in 13 months from the date the Company took over as operator. Production at Eureka at the end of June 2008 was approximately 1,000 boe/d. In the third quarter of 2008, the Company completed the refurbishment of the rig on Eureka and began working over six additional wells to add a further 1,000 boe/d. On October 23, 2008, the Company reached its phase II production target of 2,000 boe/d bringing the total production to approximately 3,300 boe/d from the Beta Field. In 2009, the Company will be working towards achieving the next production target which will bring Eureka back to the full production volume at the time the platform was shut in, approximately 4,600 boe/d.

As a result of the production increases, LOE for the Beta Field decreased 14.5% to \$28 per barrel in the third quarter 2008 from \$33 per barrel in the second quarter of 2008 and decreased 37.5% compared to \$46 per barrel for the third quarter of 2007.

Capital spending for the third quarter of 2008 was \$3.4 million, principally to bring on the additional production at Platform Eureka.

Alaska Operations

Production in Alaska was 4,508 boe/d for the third quarter of 2008. This production level is up 4.7% from the second quarter of 2008, and down 2.5% from September 2007 the first month following acquisition in late August 2007. LOE declined 2.2% to \$40 in the third quarter 2008 from \$41 per barrel in the second quarter of 2008. Capital spending for the third quarter of 2008 was \$7.5 million.

Results of Operations

Results of Operations—For Period ending September 30, 2008

Factors Affecting Comparability

We acquired the Beta Unit in March 2007 and the Alaska properties in August 2007. Our results of operations from period to period are less comparable because of the effects of these acquisitions and our limited history of operating these assets.

On July 10 and July 30, 2008, we closed the sale of our two onshore California assets, LA Basin and San Joaquin respectively for a combined net consideration of \$128 million, after reduction for customary adjustments. The discussion below presents the sold properties as assets held for sale for all historical periods and only discusses comparisons from continuing operations. Note that the discussion of the third quarter of 2008 to the second quarter of 2008 compares only continuing operations.

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Income Statement Comparison

	<u>Third Quarter September 30, 2008</u>	<u>Second Quarter June 30, 2008</u>	<u>Third Quarter September 30, 2007</u>
REVENUES			
Oil and gas production revenue	\$ 67,340	\$ 69,721	\$ 26,064
Royalties	(16,824)	(15,533)	(2,583)
Realized gain (loss) on derivatives	(16,105)	(18,095)	(905)
Interest and dividends	1,142	1,452	2,145
Loss from nonconsolidated subsidiary	(373)	(228)	-
Other revenue	57	36	(404)
	<u>35,237</u>	<u>37,353</u>	<u>24,317</u>
EXPENSES			
Production	21,350	22,885	18,608
Transportation	1,130	1,098	15
General and administrative	2,553	2,703	2,091
Stock compensation	1,564	1,860	1,669
Liquidated damages	840	1,400	-
Interest - cash	17,746	17,437	3,281
Interest - non-cash	7,233	7,106	1,583
Accelerated expensing of accretion and amortization of deferred financing costs	-	-	-
General exploration	701	769	32
Depreciation, depletion and amortization	6,959	7,001	15,903
	<u>60,076</u>	<u>62,259</u>	<u>43,182</u>
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAX			
	(24,839)	(24,906)	(18,865)
Income tax expense	-	-	-
	<u>(24,839)</u>	<u>(24,906)</u>	<u>(18,865)</u>
NET INCOME (LOSS) FROM CONTINUING OPERATIONS			
	(24,839)	(24,906)	(18,865)
Income (loss) from discontinued operations net of tax	(383)	(8,432)	(1,445)
Gain from sale of discontinued operations net of tax	74,441	-	-
	<u>74,058</u>	<u>(8,432)</u>	<u>(1,445)</u>
NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX			
	74,058	(8,432)	(1,445)
NET INCOME (LOSS)			
	<u>\$ 49,219</u>	<u>\$ (33,338)</u>	<u>\$ (20,310)</u>
Basic and diluted income (loss) per share from continuing operations	\$ (0.12)	\$ (0.12)	\$ (0.13)
Basic and diluted income (loss) per share from discontinued operations	<u>0.36</u>	<u>(0.04)</u>	<u>(0.01)</u>
Basic and diluted income (loss) per share	<u>\$ 0.24</u>	<u>\$ (0.16)</u>	<u>\$ (0.14)</u>

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Revenues

Revenue for the third quarter ended September 30, 2008 of \$67.3 million was down 3.4% compared to the second quarter of 2008 and up 158.4% from the third quarter of 2007. Production from continuing operations was up 9.3% from the second quarter of 2008 while the average realized price for our crude oil was down 7.5% from the same quarter. Production in the third quarter of 2008 was up 144.5% from the third quarter of 2007 reflecting the addition of Alaska production for a full quarter in 2008 compared to a single month in the 2007 quarter, and the ongoing return of production from Platform Eureka.

Oil production from Alaska for the third quarter of 2008 was up 4.7% from the second quarter of 2008.

Production from the Beta Field for the third quarter of 2008 was up 17.4% from the second quarter of 2008 with a decrease in realized price for oil of 6.3% for the same period respectively. This increase is the result of the ongoing return to production of Platform Eureka.

Oil production from the Beta Field now accounts for approximately 41.3% of our total production from continuing operations.

Based on annualizing third quarter 2008 production levels, a \$10 per barrel change in oil prices would change revenue net of royalties (after factoring in our hedge position) by approximately \$4.7 million per year.

Third Quarter 2008	Alaska	Beta Unit	Total
Oil Production (bbls)	380	267	648
Oil Production (bbls per day)	4,134	2,905	7,038
Sold Production (bbls)	327	267	594
Realized Price per Barrel	\$115.99	\$105.25	\$111.16
Oil Revenue	\$ 37,940	\$ 28,126	\$ 66,067
Gas Revenue	1,287	-	1,287
Total Gross Revenue	<u>\$ 39,227</u>	<u>\$ 28,126</u>	<u>\$ 67,353</u>
% of Field Contribution \$'s	57.17%	40.99%	98.16%
% of Field Contribution Barrels	57.85%	40.65%	98.49%
Lease Operating Expense (LOE)	\$ 16,709	\$ 7,601	\$ 24,310
LOE per BOE	\$40.29	\$28.44	\$35.65
(thousands except per barrel/day amounts)			

The difference between oil production and oil sold is due to the timing of liftings and shipping. We recognize revenue only once the oil has been shipped to a refinery and title passes.

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Royalties

Royalties increased from \$15.5 million in the second quarter of 2008 to \$16.8 million for the third quarter of 2008 (up 8.3%). The increase in expense is primarily due to the increased production from the Beta Field (Platform Eureka). Royalty expense is up from the third quarter of 2007 by 551.3% since the Alaska acquisition closed in August of 2007 and there was no production from Platform Eureka. In addition, an additional overriding royalty on the Beta Field became effective on sale of the LA Basin properties in July 2008.

Realized Gain (Loss) on Derivatives

Our exposure to gains and losses on hedging is primarily due to the hedges we have in place for the Beta Field's and the Alaska properties' production. See the Financial and Other Instruments section for a schedule of the hedge contracts currently in place. We have not entered into any new hedges during the third quarter of 2008, however, as a partial use of proceeds from our onshore divestitures, approximately \$30 million was used to reduce our hedging volume attributed to onshore California production.

Our realized loss on derivative contracts for oil production decreased from \$18.1 million in the second quarter of 2008 to \$16.1 million for the third quarter of 2008 representing an 11.0% decrease. Decreases in realized losses are offset by decreases in oil revenue for the equivalent barrels hedged. We did not have any significant realized hedging losses in the third quarter of 2007. The decrease from the second quarter of 2008 is a direct result of the 7.5% decrease in the realized price received for our crude oil production down from a second quarter 2008 average of \$120 to \$111 per barrel for the third quarter of 2008. We do not have any hedges in place for our gas production as it is all consumed during the process of producing oil.

Production Expenses

Production expenses decreased to \$21.4 million for the third quarter of 2008 from \$22.9 million in the second quarter of 2008. Production expenses include LOE, other direct costs and inventory change. LOE for the Beta Unit of \$7.6 million increased 1.4% from the second quarter of 2008 and decreased 14.5% on a per barrel basis from the second quarter of 2008. LOE for our operated and non-operated assets in Alaska of \$16.7 million increased from the second quarter of 2008 by 3.5% and decreased 2.2% on a per barrel basis from the second quarter of 2008. LOE from continuing operations of \$24.3 million increased on a company wide basis by 2.8% from the second quarter of 2008 and decreased 7.0% on a per barrel basis for the same period. This decrease on a per barrel basis is expected to continue as a result of improved operational synergies most notably from the Beta Field as a result of increased output from Platform Eureka.

Production expense increased by 14.7% from the third quarter of 2007 due to the increase in production brought on by the Alaska acquisition and continued increases in production from the Beta Field.

Transportation Expense

Transportation expense is primarily due to the tariff paid to the Cook Inlet Pipe Line Company (CIPL) of which we are a 50% owner. Transportation expense for the third quarter of 2008 was up 2.9% from the second quarter of 2008 reflecting a slight increase in Alaska production.

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General and Administrative Expenses

General and Administrative (“G&A”) expenses decreased slightly from \$2.7 million for the second quarter of 2008 to \$2.6 million for the third quarter of 2008. We expect the level of G&A spending to stay relatively flat even as additional production is brought on line.

Stock Compensation

Stock Compensation expense decreased 15.9% from \$1.9 million for the second quarter of 2008 to \$1.6 million for the third quarter of 2008. This expense is calculated based on the estimated intrinsic value of the underlying shares at time of grant, as determined by using the Black-Scholes method, which non-cash expense is then spread over the vesting period. This expense was down from the third quarter of 2007 by 6.3%.

Liquidated Damages

As part of the private placement that closed in January 2007, certain registration rights were granted along with the shares sold. These registration rights obligated us to file a Form S-1 Registration Statement with the US Securities and Exchange Commission (“SEC”) by the end of August 2007. Because this deadline was not met, we became obligated to issue liquidated damages shares under the agreement payable in the amount of 1% per month of the total shares issued, to shareholders who had not sold before the statement was filed. The Liquidated Damages expense represents the fair value of the underlying shares that we issued. The amount ceased once 10% of the total shares issued in January 2007 is reached. We are evaluating the appropriate time to complete the necessary amendment to the Form S-1 filed in the first quarter of 2008. Once filed, it may take several months in order to become effective.

The Liquidated Damages expense decreased 40% from \$1.4 million in the second quarter to \$0.8 million in the third quarter of 2008 due to a reduced number of shares issued, and a lower stock price. There was no Liquidated Damage expense for the year ago period.

Interest Expense - Cash

Interest Expense - Cash increased from \$17.4 million in the second quarter of 2008 to \$17.7 million in the third quarter of 2008. The expense is up from the third quarter of 2007 as the Alaska purchase closed on August 2007 representing a partial quarter of the higher debt burden.

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Interest Expense – Non Cash

Interest Expense – Non Cash increased from \$7.1 million in the second quarter of 2008 to \$7.2 million in the third quarter of 2008. The expense is up from the third quarter of 2007 as the Alaska purchase closed on August 27, 2007 representing a partial quarter of the higher debt burden.

Depreciation, Depletion and Amortization

Depreciation, Depletion and Amortization (“DD&A”) expense remained flat at \$7.0 million for the second quarter of 2008 and for the third quarter of 2008. DD&A expense in the third quarter of 2007 was \$15.9 million reflecting the initial DD&A estimate for the preliminary purchase price allocation for the August 24, 2007 acquisition of our Alaskan operations.

Net Loss from Continuing Operations

Our net loss from continuing operations was \$24.8 million for the third quarter of 2008, unchanged from the second quarter 2008 net loss from continuing operations of \$24.9 million. The third quarter 2008 net loss from continuing operations was a 31.7% increase from the year ago quarterly net loss of \$18.9 million.

Achieving profitability is dependent on the following factors. We believe we are making good progress increasing our production and bringing our production expenses down on a per barrel basis. As we bring on additional unhedged production and as our hedged volumes decline over the next few years, we expect our average realized price per barrel net of hedging losses to increase. In addition, it is important to reduce our leverage ratio to access lower cost debt, in order to reduce our interest expense. Achieving profitability is of course dependant on the market price for our production. Note that the benchmark WTI crude oil price dropped 35% in October 2008, compared to the average WTI price for the third quarter of 2008.

Results from Discontinued Operations and Gain on Sale of Discontinued Operations

The results from discontinued operations was a \$0.4 million loss in the third quarter of 2008, compared to an \$8.4 million loss in the second quarter of 2008 and a \$1.4 million loss in the third quarter of 2007. The third quarter 2008 includes only a portion of July until the closing date.

During the third quarter, we divested of our onshore California assets and reported a one time gain on the sale of these assets of \$74.4 million, after tax.

Net Income (Loss)

Including the significant \$74.4 million gain on sale, our net income was \$49.2 million in the third quarter of 2008, compared to a net loss of \$33.3 million in the second quarter of 2008 and a net loss of \$20.3 million in the third quarter of 2007.

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Balance Sheet

Our cash position was \$6.7 million as of September 30, 2008. Our total assets were \$660.8 million, down from \$691.9 million for December 31, 2007.

Debt is discussed below under "Capital Resources and Liquidity" and under "Capital Structure".

Capital Resources and Liquidity

Debt

The Company's primary sources of borrowings are pursuant to three credit agreements with affiliates of The Goldman Sachs Group, Inc. ("Goldman") and Silver Point Finance LLC ("Silver Point"). These affiliates are also owners of a significant number of common shares and warrants. An affiliate of Goldman is the counterparty for the Company's commodity swaps. The credit and swap agreements contain covenants and restrictions, including a requirement that all cash receipts are to be deposited into lockboxes and require the Company to obtain Goldman or Silver Point approval for the disbursement of funds out of the lockboxes.

As at September 30, 2008 and as of the date of this report, the Company was not in compliance with all covenants under these agreements, and accordingly all amounts due under the credit agreements have been classified as current liabilities as of September 30, 2008 in accordance with accounting requirements. In addition, the long term portion of the derivative liability to Goldman has been classified as a current liability instead of as a long term liability as the swap agreement is linked to the credit agreements through cross defaults.

Neither Goldman nor Silver Point has expressed any demand for repayment of amounts outstanding under the credits agreements nor expressed any demands under the swap agreements. Negotiations for amendment of the agreements are underway.

Our credit facilities currently require that we raise an additional \$85 million by March 31, 2009 from the sale of our common stock (or, upon approval by the lenders, preferred stock or convertible debt), lender-approved divestitures or other capital-raising activities as may be reasonably satisfactory to the lenders. Of the proceeds raised by March 31, 2009, at least \$85 million must be used to prepay indebtedness under the Alaska second lien credit agreement. Proceeds in excess of \$85 million that are not used to prepay the second lien credit agreement must be deposited into our credit facility lockbox accounts and may be used for exploration and development and working capital purposes as permitted by the approved plan of development or as otherwise permitted by our credit facilities.

The Company's ability to continue operations as planned, including capital spending on the schedule desired, is dependent upon a successful amendment of these agreements with Goldman and Silver Point.

We are also required under our credit agreements to hedge against the interest rate risk associated with the variable portion of our long term debt facilities. We have not entered into any interest rate hedges at this time. We have been in discussions with our lenders to discuss the appropriate strategy, timing, and amount of interest to swap, if any, in the pending amendments to our credit agreements.

There is no assurance that amended agreements with the lenders can be achieved.

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Surety Line

The Company continues to work towards the establishment of a surety line to allow it to replace a portion of the approximate \$100 million in cash it has on deposit for abandonment liability and performance deposits. If the Company is able to secure a new surety line, and provide surety bonds in amounts and form required by regulatory agencies, restricted cash freed up as a result thereof would be used to repay a portion of its debt.

Capital Expenditures

The extent of our capital expenditure program for the fourth quarter of 2008 is dependent on the outcome of the amendments to our credit agreements.

As a requirement to maintain its Corsair Unit exploration leases in good standing, on October 31, 2008 the Company submitted a conditional contract for a heavy lift vessel to transport a jackup rig to the State of Alaska. This contract was entered into jointly with a third party who will be responsible for 50% of the mobilization costs should the contract become effective. There are several conditions necessary for the contract to become effective including a request to the State of Alaska Department of Natural Resources to extend a number of leases for as many as 3 years. These leases include the Company's as well as leases of the third party. The Company has not received word back from the State of Alaska as to whether the leases will be extended or if this contract will satisfy the requirements for the Corsair leases. If the State does not accept the conditional transportation contract or the Company's request to extend the leases, the Company may not be able to retain legal title to the Corsair Unit leases.

By way of background, the Company's primary exploration prospect consists of the Corsair Unit leases in the Cook Inlet, Alaska. The Corsair Unit consists of four state leases totaling approximately 27,000 acres in which the Company holds a 100% working interest. These leases have several specific obligations to the State of Alaska that must be met in order to maintain the leases. The obligations for the core leases include evidence of a rig capable of drilling the prospect, evidence of transportation for the rig, and drilling of the prospect that must commence during the 2009 drilling season by June 30, 2009. The Company has previously demonstrated contractual evidence of a rig to drill the Corsair prospect. The Company plans to bring in a partner to fund the future costs of Corsair.

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Cash Flows for the nine months ending September 30, 2008 and September 30, 2007

The following table summarizes our net cash provided by or used in our operating activities, investing activities and financing activities for the nine months ended September 30, 2008 and September 30, 2007 including discontinued operations.

	2008	2007
Net cash provided by (used in) operating activities	(\$14,241)	(\$19,904)
Net cash provided by (used in) investing activities	\$59,241	(\$30,016)
Net cash provided by (used in) financing activities	(\$45,499)	\$42,000
Net change in cash	(\$499)	(\$7,920)

Net cash used in operating activities was \$14.2 million compared to net cash used by operating activities of \$19.9 million for the nine months ended September 30, 2007. The reduction in net cash used is a reflection of the 2007 acquisitions of Beta (March 2007) and the Alaskan properties (August 2007). Increased revenues from these acquisitions and subsequent production increases were partly offset by higher royalty expense, production expense, and general and administrative expense. Increased interest expense more than offset the net of these amounts. Working capital changes were positive in the 2008 period. Finally, less cash was used in discontinued operations.

Net cash provided by investing activities was \$59.3 million including net proceeds of \$127.7 million from the sale of our onshore properties, less \$29.7 million to terminate related hedges, and \$6.4 million to close out the non-controlling interest portion of these properties. Offsetting these proceeds were capital expenditures of \$32.3 million in 2008, compared to \$28.2 million in the same period of 2007.

Net cash used in financing activities was \$45.5 million for the nine months ended September 30, 2008, principally reflecting \$63.0 million of debt repaid from the proceeds of the asset sale. There was \$19.2 million of proceeds for stock issued earlier in the year. In the comparable 2007 period, net cash provided by financing activities was \$42.0 million reflecting borrowings under the credit facilities.

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Debt

The following schedule provides the detail of our current outstanding debt.

Notes Payable

Description	September 30, 2008	December 31, 2007
Notes Payable to Goldman Sachs and Silver Point		
Beta senior secured	\$ 20,028	\$ 65,000
Alaska first lien	108,000	108,000
Alaska second lien	302,991	285,269
Face value of notes payable to Goldman Sachs and Silver Point	431,019	458,269
Forest zero coupon note payable	32,303	29,976
Unsecured shareholder loan	1,000	-
Total face value of notes payable	464,322	488,245
Unamortized discounts	-	(27,097)
Unamortized debt issue costs	-	(27,277)
Book value of notes payable	464,322	433,871
Current portion of notes payable	(432,019)	-
Long-term portion of notes payable	\$ 32,303	\$ 433,871

As a partial use of proceeds from the sale of both of our onshore California assets that closed in the third quarter, we made two debt repayments: \$18.0 million went to payoff the full outstanding balance of the Laurus note (which note is included in the Liabilities Held for Sale at December 31, 2007, not in notes payable above), and \$45.0 million was used to partially repay the Beta Senior secured note (part of the Goldman and Silver Point notes payable above).

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Capital Structure

Our Goldman and Silver Point debt balance of \$431.0 million as of September 30, 2008 reflects the debt portion of the funding of acquisitions of the Alaska assets in August 2007 and Beta Unit in March 2007, the funding of the first stages of a significant capital expenditure program to develop these assets to increase production, less a partial repayment in July 2008 from the proceeds of our onshore properties divestiture.

As we have stated in the past, reducing our leverage ratio (ratio of debt to EBITDA) is one of our key corporate goals. The first part of this reduction occurred in the third quarter of 2008, with \$45 million of the proceeds from the July 2008 asset sale used to repay a portion of this indebtedness. Increasing production at the Beta Field is also contributing to a reduction in the leverage ratio by increasing EBITDA. Further alternatives to reduce our leverage ratio include accessing surety lines to replace the cash on deposit securing our abandonment liabilities, securing third party investors for a portion of our capital program, selling some or all of our Alaska operations and equity sales. These alternatives are under review to determine the best course of action to increase shareholder value.

As disclosed above, we are currently renegotiating our credit agreements with Goldman and Silver Point, although no assurance can be given that we will achieve our objectives in such renegotiation.

Over time, once our leverage ratio is reduced, we expect to refinance some or all of our then-remaining Goldman and Silver Point notes payable with a conventional reserve-based loan at a significantly lower interest rate; however, no assurance can be given that conventional financing at desirable rates will be available at such time or when this refinancing can be accomplished.

A fluctuation in interest rates of 1.0% would change interest expense by \$4.0 million per year based on the outstanding floating rate debt as of September 30, 2008.

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Warrants Exercised

The following table shows warrants that were exercised in the nine months ended September 30, 2008:

2008 Warrants Exercised

	Number	(Canadian dollars)	
		APIC	\$/Share
Canadian Exercised (1/9/08)	10,000	\$ 15,000	\$ 1.50
Canadian Exercised (1/15/08)	625	938	1.50
Canadian Exercised (1/18/08)	8,717,738	14,820,155	1.70
Canadian Exercised (1/18/08)	2,876,145	4,889,447	1.70
Canadian Exercised (1/18/08)	401,400	682,380	1.70
Canadian Exercised (1/18/08)	175,723	298,729	1.70
Total Exercised in 2008	12,181,631	20,706,648	1.70

(APIC stands for additional paid in capital)

This table is current as of October 31, 2008.

Cash & Cash Equivalents

As of November 5, 2008, we had a cash balance of approximately \$3.7 million. In addition, we have approximately \$104 million of cash securing performance bonds and other abandonment based obligations. Our access to the surety market, with the goal of replacing a portion of the cash deposits with surety bonds, is dependent in part on reaching a longer term agreement with our Lenders.

Future Dividends

We have not declared or paid any cash dividends on our capital stock in the past, and we do not anticipate declaring or paying cash dividends on our common stock in the foreseeable future. In addition, our credit facilities prohibit the payment of dividends without lender consent.

We will pay dividends on our common stock only if and when declared by our board. Our board's ability to declare a dividend is subject to restrictions imposed by Delaware law. In determining whether to declare dividends, our board will consider these restrictions as well as our financial condition, results of operations, working capital requirements, future prospects and other factors it considers relevant.

Off-Balance Sheet Arrangements

We have entered into crude oil hedging contracts which are discussed below in the Financial and Other Instruments section in more detail. These production and swap contracts require us to make a settlement payment for any rise in the market price of crude oil above the contract price. Higher prices received on physical production that has been hedged will generally be offset by settlement payments to our counterparty pursuant to the swap contract (and vice versa). While we believe we have an appropriate mix of hedged and unhedged crude oil production, we are at risk in the event of a decrease in our actual realized production volumes below our hedged production volumes.

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Related Party Transactions

Transactions with related parties are measured at their fair value as determined by management. The transactions listed below are unsecured and due under normal trade terms.

- a) In April 2008, the Company received a \$1.0 million unsecured loan from a shareholder. The loan is payable on demand at 9% annual interest, and was used for general working capital purposes.
- b) As of September 30, 2008, the Company owed \$75.8 thousand to Basin Supply Company LLC. Basin Supply is owned and controlled by Vladimir Katic, our CEO. Basin Supply is a surplus parts company that existed at the time the Company first acquired the LA Basin assets and was used from time to time to acquire parts for maintenance work. As the LA Basin assets have recently been sold, we do not expect to incur any additional costs associated with this related party.
- c) During the first nine months of 2007, the Company incurred legal costs of approximately \$247.8 thousand with the law firm of Devlin Jensen, Barristers & Solicitors, who act as our Canadian counsel. Pat Devlin, a member of our board of directors, was a partner with Devlin Jensen, until October 31, 2007.

Changes in Accounting Policy

There were no changes to any significant accounting policies during the third quarter of 2008.

Financial and Other Instruments

Our financial assets and liabilities consist of cash, derivatives, short-term investments, receivables, accounts payables, notes payable, and accrued liabilities. We have placed our cash and cash equivalents in liquid bank deposits, which provide a variable rate of interest. We have significant bonding obligations for several of our operations which require the purchase of some form of surety. To date we have funded our bonding obligations by placing cash in restricted accounts and securing our obligation 100% by the estimated bonding amount. We have engaged an outside firm to assist us in securing a surety line as a means to free up some of the restricted cash which currently is in excess of \$100 million.

Due to the historical volatility of crude oil and natural gas prices, as well as credit agreement requirements, we have an ongoing hedging strategy aimed at reducing the variability of the prices we receive on our production and providing a calculable minimum revenue stream. Currently, we have entered into production swaps aimed at ensuring a minimum amount of revenue is realized sufficient to cover our existing debt burden. As we layer on incremental and new production, we will review the appropriate level of our commodity hedging strategies.

The total derivative liability of \$105.6 million as of September 30, 2008, compared to \$89.5 million at December 31, 2007. The recorded value depends on the market price for the future volumes of our hedge contracts. The classification of this liability as a current liability at September 30, 2008 is the result of cross default provisions relating to covenant violations in our Goldman and Silver Point credit facilities, although the counterparty, Goldman, has expressed no demands for settlement. The increase in this balance is reflected in the change in accumulated other comprehensive income on the balance sheet. Generally accepted accounting principles require the derivative to be marked to market, but do not allow for the related increase in the

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present value of our hedge oil reserves to be recorded and offset against the derivative liability. We have hedged only a fraction of our total proved reserve base.

The following table provides an overview of our hedging contracts currently in place. These cover both Alaska and Beta operations. We did not enter into any new hedge contracts during the third quarter of 2008.

Hedge Position as of September 30, 2008

Alaska

Type	Volume	BPD^(C)	Term	Price (\$/bbl)^(A)	Type
Swap	247,337	2,688	October 1 - December 31, 2008	\$ 68.16	Financial
Swap	907,999	2,488	January 1 - December 31, 2009	\$ 67.21	Financial
Swap	675,422	1,850	January 1 - December 31, 2010	\$ 67.21	Financial
Swap	272,416	746	January 1 - December 31, 2011	\$ 67.21	Financial
Swap	132,812	363	January 1 - September 30, 2012	\$ 67.21	Financial

^(A) Swap price based on WTI

Beta

Type	Volume	BPD	Term	Price (\$/bbl)^(B)	Type
Swap	69,931	760	October 1 - December 31, 2008	\$ 57.75	Financial
Swap	260,512	714	January 1 - December 31, 2009	\$ 57.30	Financial
Swap	232,400	637	January 1 - December 31, 2010	\$ 57.30	Financial
Swap	207,460	568	January 1 - December 31, 2011	\$ 57.10	Financial
Swap	110,633	302	January 1 - September 30, 2012	\$ 56.90	Financial

^(B) Swap price based on Midway Sunset

Total

Type	Volume	BPD	Term	Price (\$/bbl)	Type
Swap	317,268	3,448	October 1 - December 31, 2008	\$ 65.87	Financial
Swap	1,168,511	3,202	January 1 - December 31, 2009	\$ 65.00	Financial
Swap	907,822	2,487	January 1 - December 31, 2010	\$ 64.67	Financial
Swap	479,876	1,314	January 1 - December 31, 2011	\$ 62.84	Financial
Swap	243,445	665	January 1 - September 30, 2012	\$ 62.52	Financial

^(C) Barrels per day

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We are also required under our credit agreements to hedge against the interest rate risk associated with the variable portion of our long term debt facilities. We have not currently entered into any interest rate hedges at this time. We have been in discussions with our lenders to discuss the appropriate strategy, timing, and amount of interest to swap based on the anticipated amendments of our credit agreements.

Outstanding Share Data

The following table represents our outstanding share data, and is current as of October 31, 2008.

Corporate Common Share Capitalization Table

	September 30, 2008	June 30, 2008	December 31, 2007
Total share outstanding	200,877	200,230	185,994
Shares issued for damages	4,592	4,546	648
Total shares underlying warrants	90,121	89,459	90,041
Stock options	18,116	18,546	12,002
Potential fully diluted stock count	313,706	312,781	288,685

Selected Quarterly Information

The following tables show revenue and income data of the most recent eight quarters:

	For the Three Months Ended			
	30-Sep-08	30-Jun-08	31-Mar-08	31-Dec-07
Total Oil & Gas Revenue	\$ 67,340	\$ 69,721	\$ 60,299	\$ 52,237
Net Income (Loss)	\$ (24,839)	\$ (24,906)	\$ (88,187)	\$ (59,702)
Net Income (Loss) per share (basic)	\$ (0.12)	\$ (0.12)	\$ (0.44)	\$ (0.42)

Note: June and September periods are shown without discontinued operations

	For the Three Months Ended			
	30-Sep-07	30-Jun-07	31-Mar-07	31-Dec-06
Total Oil & Gas Revenue	\$ 26,064	\$ 9,660	\$ 6,845	\$ 3,270
Net Income (Loss)	\$ (20,310)	\$ (9,273)	\$ (6,447)	\$ (10,499)
Net Income (Loss) per share (basic)	\$ (0.13)	\$ (0.08)	\$ (0.07)	\$ (0.18)

Note: June and September periods are shown without discontinued operations

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Subsequent Events

We are required to submit quarterly and annual certificates of compliance to each of our lenders stating that we believe we are in compliance of all required loan covenants or what our plan of action may be in the event we are not fully in compliance with one or more loan covenants. We are not in compliance with several financial ratios, including debt to EBITDA and the current ratio (the ratio of current assets to current liabilities), and several non-financial covenants. We are currently in negotiations with Goldman and Silver Point to amend our credit agreements.

In the event that we are unable to cure these violations or receive waivers, and the lenders were to call our debt, we could be required to seek alternative capital or engage in additional asset sales in order to reduce or pay off that debt or pursue a restructuring of the Company.

Business Risks & Risks Management

Except for historical information contained in this discussion and analysis, disclosure statements contained herein are forward-looking, which statements are subject to risks and uncertainties, which could cause actual results to differ materially from those in such forward-looking statements. Our long-term commercial success depends on our ability to find, acquire, develop, and commercially produce oil reserves. We attempt to reduce these risks through the combination of experienced personnel with local knowledge and careful evaluation. For example, in our two operations, offshore California and Cook Inlet Alaska, we have retained personnel with historical knowledge of both the assets and the areas of operations. In some cases key personnel were acquired with the acquisitions. In other cases we actively recruited for these personnel.

External factors beyond our control may affect the marketability of the oil and gas produced, however, we believe we have selected appropriate personnel to monitor field operations and have automated some field information where possible so that difficulties and operational issues can be assessed and dealt with on a timely basis and production maximized as much as possible.

Oil and gas exploration, development, and production operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts and spills, each of which could result in damage to wells, production facilities, other property and environment, or in personal injury. In accordance with industry practice, we insure against most of these risks (although not all such risks are insurable). We maintain liability insurance in an amount that we consider consistent with industry practice; although the nature of these risks is such that liabilities could potentially exceed policy limits.

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Future Prospects

We are optimistic about the growth potential of the Company and acknowledge that of critical importance to realize our potential requires us to restructure our capital structure to decrease our leverage and lower our cost of debt. We have a large number of proved undeveloped locations in inventory to be drilled. The prospect of returning Platform Eureka to full production is expected to add substantial further growth in proved developed reserves and production in 2009 and beyond. Although there are some mechanical and operational challenges inherent in areas of our operations, with proper risk management and careful evaluation, we believe that we can achieve growth in production, reserves, and cash flow. We continue to evaluate and pursue potential producing reserve acquisitions in our strategic areas of operation.

Internal Disclosure Controls

We place considerable importance on the appropriate capture and reporting of financial information. We further recognize the need for timeliness with respect to management reporting to the appropriate internal personnel including the Chief Executive Officer, the President and the Chief Financial Officer among others, and the importance of effectively communicating relevant information to the investor community. With that in mind, we have designed internal controls specifically aimed at providing a reasonable level of assurance that material transactions are reported, accounted for properly, and effectively communicated to key decision makers within the organization. No internal control system will prevent intentional omissions or fraud.

We have determined we have a number of material weaknesses in our internal reporting systems as a result of our increased complexity and small corporate staff. In addition, we have recently been subject to a periodic review by a regulatory authority and expect to file amended forms on completion of their review as follows: 2007 Annual Information Form, 2007 Management's Discussion and Analysis, National Instrument 51-101 Oil and Gas Disclosure Form 51-101 and Business Acquisition Report (dated November 9, 2007).

We are working to address these control issues, and have made progress in the third quarter of 2008. We believe these deficiencies include: a less than adequate number of qualified accounting staff, a less than adequate number reserve engineers and technical staff, and an extensive reliance on the use of outside consultants. At this time, we conclude that our internal controls are less than adequate for our current size and complexity, but are confident that we have a plan to augment these controls to a more appropriate level. We continue to review our progress with the audit committee.

In accordance with Multilateral Instrument 52-109, our Chief Executive and Chief Financial Officers are required to sign individual Certifications of the Annual Filings. These have been filed separately from the Management Discussion and Analysis and are available for viewing on SEDAR.com.